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Benefits of survivorship life insurance
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ABSTRACT: A survivorship life insurance policy insures a couple, but pays a death benefit only when the 2nd insured person dies. This feature complements use of the marital estate tax deduction, which defers estate tax until the death of the 2nd insured person. A survivorship policy can be structured so that both people are insured, but insurance proceeds are not included in either person's taxable estate. And since survivorship insurance does not pay until the death of the 2nd person, it often is cheaper than the cost of purchasing a single life insurance policy for each person.

TEXT: A survivorship life insurance policy insures a couple, but pays a death benefit only when the second insured person dies. This feature complements use of the marital estate tax deduction, which defers estate tax until the death of the second insured person.

A survivorship policy can be structured so that both people are insured, but insurance proceeds are not included in either person's taxable estate. And since survivorship insurance does not pay until the death of the second person, it often is cheaper than the cost of purchasing a single life insurance policy for each person.

To keep survivorship insurance proceeds from being considered part of a couple's estate, neither person can have ownership rights to the policy. The rights instead should be acquired and held by another party, such as an adult child of the insureds.

Another option is to create an irrevocable life insurance trust. A trust can protect the proceeds from estate taxes and would help to facilitate use of the death benefit as intended by the insureds. Special care needs to be exercised when structuring the trust to make sure neither insured person has control over the trust that would cause estate inclusion.

A typical case

Assume an estate includes sizable assets such as a business or real estate that cannot be liquidated easily to pay estate taxes. If those assets are left to the surviving insured person, there is no estate tax burden after the death of the first insured person. But there could be a major liquidity problem after the death of the second insured person. A survivorship life insurance policy is designed for a scenario where a major liquidity problem might exist.

However, the surviving insured person must have sufficient income from other sources, since no death benefit will be paid upon the death of the first insured person. The key is to carefully weigh the need for liquidity upon the death of the first insured person against the surviving person's income needs.

Premiums for a survivorship life insurance policy tend to be considerably lower than premiums for a single life insurance policy for each person because proceeds of the survivorship life insurance policy always will be paid out later than the proceeds of the single life insurance policy of the first person to die, except for instances when the couple dies at the same time.

Since the entire annual survivorship premium likely will be paid over a longer time (two life expectancies), the ultimate cost may be higher than two single life insurance policies. Also, the fact that the survivorship benefit is paid later reduces its present value. In other words, inflation will erode the purchasing power of the death benefit over time.

However, if one person is uninsurable due to health problems, a survivorship life insurance policy still may cover the couple at a potentially lower cost than insuring the healthy person under a single policy.

A survivorship life insurance policy may be used to pay estate taxes on the transfer of a closely held business to a younger family member who plans to keep the business after the owner's death.

Limitations

A survivorship life insurance policy is designed to work in conjunction with the unlimited marital income tax deduction. If the deduction is repealed by future tax legislation or a couple is divorced, however, a survivorship life insurance policy no longer would be appropriate. Many insurance companies would allow a survivorship life insurance policy to be split into two single life insurance policies in either of these situations.

A survivorship life insurance policy could be less cost effective then a single life insurance policy when estate assets have high appreciation potential. Deferring taxes through the unlimited marital income tax deduction could make the ultimate estate tax bill significantly higher, reflecting the additional years of appreciation between the two deaths, than if the taxes were paid on the transfer of assets following the first person's death.

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